

UNITED STATES OF AMERICA  
Before the  
COMMODITY FUTURES TRADING COMMISSION

CHENLI CHU

v.

PEREGRINE FINANCIAL GROUP, INC.  
and JAMES FRANCIS KELLY

CFTC Docket No. 07-029

ORDER

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Nicholas P. Iavarone ("Iavarone"), one of respondents' attorneys, petitions for interlocutory review of a June 16, 2008 order of an Administrative Law Judge ("ALJ") debaring him from further participation in this reparations proceeding. Respondents Peregrine Financial Group, Inc. ("Peregrine") and James Francis Kelly ("Kelly"), in a separate petition for interlocutory review, ask us to disqualify the presiding ALJ and reassign the case.

For the reasons explained below, we grant Iavarone's application and conclude that the ALJ erred in debaring him from this proceeding. We have examined Rule 12.9(b) of the Commission's Regulations, which governs attorney conduct in reparations actions. Applying that rule in the circumstances of this case, we find that the record does not support a finding that Iavarone's conduct was "contemptuous" as required by the rule. As a result, we vacate the debarment order.

Separately, we deny respondents' petition to disqualify the ALJ. While the ALJ erred in debaring Iavarone and displayed unfortunate intemperance at the oral hearing, his conduct did not exhibit the personal bias, conflict of interest or similar basis required to disqualify an ALJ under Rule 12.305.

## BACKGROUND

The debarment order resulted from the ALJ's impatience with one of respondents' attorneys in the course of the hearing of this matter. The hearing convened on June 3, 2008 in California, where complainant lives. Iavarone and the ALJ clashed throughout the hearing, during which the ALJ repeatedly threatened to debar him. *See* Hearing Transcript *passim*. When the hearing reconvened on the next day, the ALJ demanded a "sincere" apology from Iavarone for his unprofessional conduct. Tr. at 159. Dissatisfied with Iavarone's attempt, the ALJ rejected the attorney's apology for "offending the court," Tr. at 160, debarred Iavarone from appearing further, and suspended the hearing to allow respondents to obtain substitute counsel.<sup>1</sup> The session adjourned after eight minutes.

The ALJ supplemented his oral order with a June 16, 2008 Notice of Disbarment ("Notice") that characterized Iavarone's apology as "disingenuous[]." Notice at 2. The ALJ cited as evidence of Iavarone's "contumacious conduct" his "belligerent and non-cooperative attitude towards the Court," consisting of "shout[ing] his questions, objections, and various declarations . . . [and] aggressively pursuing [complainant] with questions about her citizenship, residence, and tax matters." *Id.* at 1. The ALJ cited as further evidence of Iavarone's objectionable conduct a witness's testimony that she overheard Iavarone say he intended to extend the case "forever." *Id.*; *see also* Tr. at 148-49. In addition, the ALJ stated that an unidentified court employee had complained of overhearing "shouting of an attorney emanating from the Chu proceedings." *Id.* This petition followed.

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<sup>1</sup> Respondents were represented by Peregrine's general counsel, Rebecca Wing, and Iavarone, an outside counsel retained by Peregrine. Iavarone played the principal role in litigating the case. The ALJ suspended the hearing to "give[] [Wing] ample time to find another assistant to help you." Tr. at 160.

The reparations case underlying this petition concerns \$500,000 in losses allegedly suffered by the complainant Chenli Chu (“Chu”), who is a citizen of Taiwan and whose legal residence is a matter of dispute. In her complaint, Chu described herself as a 71-year-old retiree who lives in California with her daughter. Amended Complaint at 2 (June 13, 2007).

Respondents, however, have contended throughout this proceeding that Chu is a resident of Taiwan and that the Commission lacks jurisdiction to hear her claim unless Chu files the bond required by Section 14(c) of the Commodity Exchange Act (“CEA” or “Act”) and Rule 12.13(b)(4). The statute and rule require that a complaint filed by a nonresident of the United States must be accompanied by a bond equal to double the amount of the claim. The bond requirement is jurisdictional and cannot be waived.

Respondents base their argument on Chu’s statement in a tax form filed with her account opening documents that her permanent residence for tax purposes is Taiwan. *See* Form W-8BEN (“Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding”), submitted as Exhibit 3 to Iavarone’s brief in support of his petition. Chu checked the box indicating that she is a resident of Taiwan “within the meaning of the income tax treaty” between the United States and Taiwan and thereby eligible for the tax benefits available under the treaty. While she listed Taiwan as her “permanent residents” on Form W-8BEN, she listed a California “mailing address.”

Prior to the hearing, respondents filed a motion to dismiss the case based on Chu’s failure to post the non-resident bond, which the ALJ denied. Respondents’ Motion to Dismiss for Lack of Jurisdiction (April 4, 2008). Respondents petitioned for interlocutory review of the ALJ’s order, and also asked the Commission to stay the hearing while it addressed the residency issue. By delegated authority, the Commission denied the motion to stay and instructed the ALJ “to

develop the factual record on the complainant's residency to enable the Commission to rule on the jurisdictional issue at an appropriate time." Order Pursuant to Delegated Authority at 2 (May 20, 2008). The ALJ, however, gave the instructions slight consideration. *See, e.g.*, Tr. at 94:

Iavarone: The Commission, in its order, said that to instruct the court to develop the citizenship and residency issue. Are we going to be able to do that?  
ALJ: No.

Respondent cites at least eleven instances where the ALJ threatened to debar him, commencing literally minutes into the proceedings. Iavarone Brief at 4. Our review of the hearing transcript bears this out. The first such exchange that resulted in a debarment threat from the ALJ ran as follows:

ALJ: I'm not going to sit here and hear a lot of stuff that's not included in this complaint.  
Iavarone: I think you are going to have to, Your Honor.  
ALJ: I beg to differ with you.  
Iavarone: I then have a right to make an offer of proof the Commission . . . .  
ALJ: You may do that on paper, post trial.  
Iavarone: I can't do it post trial.  
ALJ: Mr. Iavarone, do you want to remain on this case or would you like to be excused? I'm not here to listen to nonsense.

Tr. at 13.

About an hour after the lunch break, the ALJ cut short Iavarone's attempt to cross-examine Chu about her residency:

Iavarone: Have you ever filed next [sic] tax returns in the United States?  
[Objection by Chu's attorney]  
ALJ: Sustained. Absolutely. That's your last question. You are excused. You are now trying to get into tax evasion stuff.  
Iavarone: I'm doing what the Commission said in its order to develop the record on whether she's a citizen.  
ALJ: I'm debating now as to whether to remove you from the case and let your co-counsel handle the rest of it or simply proceed further. I'm seriously weighing that.

Tr. at 98. The hearing continued in similar fashion until its conclusion after just four hours of testimony.<sup>2</sup> Shortly before 3:00 p.m., the ALJ abruptly terminated Iavarone's cross-examination of Chu's witness Jen Huang, telling Iavarone, "You are through." Tr. at 150. The ALJ ignored Iavarone's question as to whether respondents would be permitted to present its defense, told Iavarone to be prepared to show why he should not be removed from the case, and adjourned the hearing until the following morning. Tr. at 150-53.

The above-described debarment and Iavarone's petition followed. Peregrine filed a memorandum supporting Iavarone's petition and its own request to disqualify the ALJ because of the "clear hostility and bias." Respondents' Memorandum in Support of Motion for Interlocutory Appeal and Reassignment at 20 (July 7, 2008). Complainant opposes both requests for relief: the motion for reassignment and the petition to vacate the debarment. Regarding the reassignment, Chu asserts that "[t]he fact that Respondents may have experienced an adverse ruling is insufficient to meet their burden" for removing an ALJ. Chu's Opposition to Respondents' Motion for Interlocutory Appeal and Reassignment at 2 (July 17, 2008). Chu characterizes the motion as "a thinly veiled retaliation for the debarment" of Iavarone. *Id.* Regarding Iavarone's petition for relief from the debarment order, Chu "submits that Respondents' vicious and undeserved attack on [the ALJ] evidences Respondents' . . . unstated goal to have this action transferred to an Administrative Law Judge who historically sides with the brokerage industry in reparations actions." Chu's Response to Attorney Iavarone's Application for Interlocutory Review Re Disbarment at 5 (July 15, 2008). During this exchange of pleadings, the ALJ stayed the case pending interlocutory review. Order Staying Proceedings (July 10, 2008).

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<sup>2</sup> The hearing convened at 9:00 a.m., recessed for a two-hour lunch break and three short breaks of approximately 10 minutes each, and concluded at approximately 3:00 p.m. Tr. at 8, 59, 71 and 153.

## DISCUSSION

*Debarment order.* Rule 12.9(b) allows a presiding officer to preclude further participation of a party's representative in a pending reparations case upon a finding that the representative is "guilty of contemptuous conduct," but provides no guidance in applying the rule. The Commission established the appropriate standard to address attorney debarment in *In re Global Minerals & Metals Corp.*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,189 (CFTC July 13, 2000). Seeking a needed balance between the right of parties to choose counsel and the need for judicial decorum, the Commission drew upon "federal court decisions interpreting 18 U.S.C. § 401, the statute authorizing federal courts to sanction criminal contempt." *Id.* at 50,231. The Commission's examination of federal precedents revealed clearly that "willfulness is an essential element of proof, and that for purposes of criminal contempt, willfulness does not exist where there is a good faith pursuit of a plausible though mistaken alternative." *Id.* "[T]here must also be sufficient proof that the misbehavior actually obstructed the administration of justice by delaying proceedings, making more work for the judge, inducing error, or imposing costs on the parties." *Id.* Misbehavior warranting debarment must be established by clear and convincing evidence. *Id.* Because the debarment rule does not provide a range of sanctions for violations of varying severity, the draconian step of debarment must be reserved for convincingly contemptuous conduct.

With these standards in mind, it is clear that the present record does not support the ALJ's debarment decision. The Commission, in the May 20 delegated authority order, requested a developed factual record on the jurisdictional issue of complainant's residence. Iavarone, whose clients' interest lay in disproving complainant's claim of U.S. residence, inquired early on whether questioning and offers of proof on the subject would be allowed. Despite the May 20

order, the ALJ responded “No.” Iavarone’s persistence in pursuing the issue cannot be deemed willful misconduct in light of the order and the requirements of Section 14(c) of the Act. Nor did Iavarone obstruct justice, delay proceedings or act to induce error. Indeed, error is more likely on a poorly developed record. We do not reach the ALJ’s statement in the debarment Notice that an unnamed court employee complained of shouting by an unspecified person, which facially does not meet the clear and convincing evidentiary standard. The debarment order accordingly is vacated.

*Motion to disqualify.* Respondents seek to disqualify the ALJ.<sup>3</sup> This motion is opposed by complainant. Under Commission Rule 12.305(b), a party can request an ALJ to disqualify himself or herself “on the grounds of personal bias, conflict of interest, or similar bases.” Interlocutory review of an ALJ’s denial of a request to disqualify is available without certification of the matter by the ALJ, under the procedures contained in Rule 12.309. *Id.* See also Rule 10.8(b)(2) (applying the same standard to administrative enforcement proceedings.)

Our precedents establish that such bias must stem from an extrajudicial source or manifest “a deep-seated favoritism or antagonism that would make a fair judgment impossible,” *i.e.*, “pervasive” bias. *In re Fisher*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,752 at 44,114 (CFTC July 22, 1996) (citation omitted); see also *Olson v. Ulmer*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,987 at 37,627 (CFTC Jan. 23, 1991). The Commission “will not resolve a dispute of disqualification on an interlocutory basis . . .

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<sup>3</sup> At various points in its pleadings, Peregrine refers incorrectly to Rule 12.202, which applies to disqualification of presiding officers in summary decisional proceedings. See, e.g., Peregrine Motion at 1, 3 (June 16, 2008). Rule 12.305(b) governs disqualification of presiding officers in formal decisional proceedings. Both rules incorporate the same standard. Peregrine’s drafting error is harmless.

absent a showing that extraordinary circumstances warrant immediate intervention.” *Fisher*, ¶ 26,752 at 44,114.

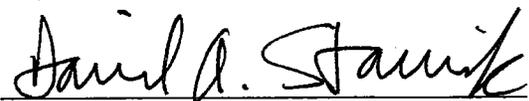
The transcript of the June 3 hearing reveals that the ALJ was unusually acrimonious and intemperate. The case record overall, however, does not reflect pervasive bias throughout the proceeding. *E.g.*, the ALJ has requested briefing on the residency issue, albeit truncated briefing limited to three pages. Notice and Order at 2 (Aug. 1, 2008). Disqualifying the ALJ and reassigning the case at this stage, when the hearing already has begun, would unnecessarily delay its resolution.

For the reasons set forth in the May 20 delegated authority order, we remain unready to rule on respondents’ petition for interlocutory review of the ALJ’s order denying their motion to dismiss for lack of jurisdiction. A Commission ruling would be premature particularly in light of the ALJ’s August 1 Notice and Order requesting briefing on the residency issue. Should the ALJ determine that the parties’ briefs, together with their documentary evidence, do not provide a sufficiently developed record on residency, we anticipate that he will provide an opportunity for testimonial evidence when the hearing resumes.

Based on the foregoing, Iavarone’s petition to vacate the debarment order is GRANTED; respondents’ motion to disqualify the ALJ and reassign the case is DENIED.

IT IS SO ORDERED.

By the Commission (Acting Chairman LUKKEN and Commissioner SOMMERS; Commissioner CHILTON dissenting in part and concurring in part; Commissioner DUNN not participating).



David A. Stawick  
Secretary to the Commission  
Commodity Futures Trading Commission

Dated: September 4, 2008

**Opinion of Commissioner Bartholomew H. Chilton, (dissenting in part and concurring in part) regarding Chenli Chu v. Peregrine Financial Group, Inc. and James Francis Kelly.**

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In the matter of Chu v. Peregrine Financial Group et al., based upon my review, I believe the record supports the ALJ determination of the defendant's conduct as "contemptuous" and therefore dissent from Commission's Order to overturn the ALJ's ruling that precludes the Peregrine counsel in question from continuing to appear in this matter. I support the Commission's Order in all other regards related to this case.

Bart Chilton, Commissioner  
Commodity Futures Trading Commission